

INTERNAL REVENUE CODE

*** CURRENT THROUGH P.L. 107-146, APPROVED 2/14/02 ***

SUBTITLE A. INCOME TAXES

CHAPTER 1. NORMAL TAXES AND SURTAXES

SUBCHAPTER E. ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART II. METHODS OF ACCOUNTING

SUBPART B. TAXABLE YEAR FOR WHICH ITEMS OF GROSS INCOME INCLUDED

IRC Sec. 457 (2002)

§ 457. Deferred compensation plans of State and local governments and tax-exempt organizations.

(a) Year of inclusion in gross income.

(1) In general. Any amount of compensation deferred under an eligible deferred compensation plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income--

(A) is paid to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(A), and

(B) is paid or otherwise made available to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(B).

(2) Special rule for rollover amounts. To the extent provided in section 72(t)(9), section 72(t) shall apply to any amount includible in gross income under this subsection.

(b) Eligible deferred compensation plan defined. For purposes of this section, the term "eligible deferred compensation plan" means a plan established and maintained by an eligible employer--

(1) in which only individuals who perform service for the employer may be participants,

(2) which provides that (except as provided in paragraph (3)) the maximum amount which may be deferred under the plan for the taxable year (other than rollover amounts) shall not exceed the lesser of--

(A) the applicable dollar amount, or

(B) 100 percent of the participant's includible compensation,

(3) which may provide that, for 1 or more of the participant's last 3 taxable years ending before he attains normal retirement age under the plan, the ceiling set forth in paragraph (2) shall be the lesser of--

(A) twice the dollar amount in effect under subsection (b)(2)(A), or

(B) the sum of--

(i) the plan ceiling established for purposes of paragraph (2) for the taxable year (determined without regard to this paragraph), plus

(ii) so much of the plan ceiling established for purposes of paragraph (2) for taxable years before the taxable year as has not previously been used under paragraph (2) or this paragraph,

(4) which provides that compensation will be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month,

(5) which meets the distribution requirements of subsection (d), and

(6) except as provided in subsection (g), which provides that--

(A) all amounts of compensation deferred under the plan,

(B) all property and rights purchased with such amounts, and

(C) all income attributable to such amounts, property, or rights,

shall remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the

provision of benefits under the plan), subject only to the claims of the employer's general creditors.

A plan which is established and maintained by an employer which is described in subsection (e)(1)(A) and which is administered in a manner which is inconsistent with the requirements of any of the preceding paragraphs shall be treated as not meeting the requirements of such paragraph as of the 1st plan year beginning more than 180 days after the date of notification by the Secretary of the inconsistency unless the employer corrects the inconsistency before the 1st day of such plan year.

(c) Limitation. The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed the amount in effect under subsection (b)(2)(A) (as modified by any adjustment provided under subsection (b)(3)).

(d) Distribution requirements.

(1) In general. For purposes of subsection (b)(5), a plan meets the distribution requirements of this subsection if--

(A) under the plan amounts will not be made available to participants or beneficiaries earlier than--

(i) the calendar year in which the participant attains age 70 1/2 ,
(ii) when the participant has a severance from employment with the employer, or

(iii) when the participant is faced with an unforeseeable emergency (determined in the manner prescribed by the Secretary in regulations),

(B) the plan meets the minimum distribution requirements of paragraph (2), and

(C) in the case of a plan maintained by an employer described in subsection (e)(1)(A), the plan meets requirements similar to the requirements of section 401(a)(31).

Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of transfer.

(2) Minimum distribution requirements. A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of section 401(a)(9).

(3) Special rule for government plan. An eligible deferred compensation plan of an employer described in subsection (e)(1)(A) shall not be treated as failing to meet the requirements of this subsection solely by reason of making a distribution described in subsection (e)(9)(A).

(e) Other definitions and special rules. For purposes of this section--

(1) Eligible employer. The term "eligible employer" means--

(A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and

(B) any other organization (other than a governmental unit) exempt from tax under this subtitle.

(2) Performance of service. The performance of service includes performance of service as an independent contractor and the person (or governmental unit) for whom such services are performed shall be treated as the employer.

(3) Participant. The term "participant" means an individual who is eligible to defer compensation under the plan.

(4) Beneficiary. The term "beneficiary" means a beneficiary of the participant, his estate, or any other person whose interest in the plan is derived from the participant.

(5) Includible compensation. The term "includible compensation" means compensation for service performed for the employer which (taking into account the provisions of this section and other provisions of this chapter) is currently includible in gross income.

(6) Compensation taken into account at present value. Compensation shall be taken into account at its present value.

(7) Community property laws. The amount of includible compensation shall be determined without regard to any community property laws.

(8) Income attributable. Gains from the disposition of property shall be treated as income attributable to such property.

(9) Benefits of tax exempt organization plans not treated as made available by reason of certain elections, etc. In the case of an eligible deferred compensation plan of an employer described in subsection (e)(1)(B)--

(A) Total amount payable is dollar limit or less. The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant's consent) if--

(i) the portion of such amount which is not attributable to rollover contributions (as defined in section 411(a)(11)(D)) does not exceed the dollar limit under section 411(a)(11)(A), and

(ii) such amount may be distributed only if--

(I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and

(II) there has been no prior distribution under the plan to such participant to which this subparagraph applied.

A plan shall not be treated as failing to meet the distribution requirements of subsection (d) by reason of a distribution to which this subparagraph applies.

(B) Election to defer commencement of distributions. The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to defer commencement of distributions under the plan if--

(i) such election is made after amounts may be available under the plan in accordance with subsection (d)(1)(A) and before commencement of such distributions, and

(ii) the participant may make only 1 such election.

(10) Transfers between plans. A participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from 1 eligible deferred compensation plan to another eligible deferred compensation plan.

(11) Certain plans excluded.

(A) In general. The following plans shall be treated as not providing for the deferral of compensation:

(i) Any bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plan.

(ii) Any plan paying solely length of service awards to bona fide volunteers (or their beneficiaries) on account of qualified services performed by such volunteers.

(B) Special rules applicable to length of service award plans.--

(i) Bona fide volunteer. An individual shall be treated as a bona fide volunteer for purposes of subparagraph (A)(ii) if the only compensation received by such individual for performing qualified services is in the form of--

(I) reimbursement for (or a reasonable allowance for) reasonable expenses incurred in the performance of such services, or

(II) reasonable benefits (including length of service awards), and nominal fees for such services, customarily paid by eligible employers in connection with the performance of such services by volunteers.

(ii) Limitation on accruals. A plan shall not be treated as described in subparagraph (A)(ii) if the aggregate amount of length of service awards accruing with respect to any year of service for any bona fide volunteer exceeds \$ 3,000.

(C) Qualified services. For purposes of this paragraph, the term "qualified services" means fire fighting and prevention services, emergency medical services, and ambulance services.

(12) Exception for nonelective deferred compensation of nonemployees.

(A) In general. This section shall not apply to nonelective deferred compensation attributable to services not performed as an employee.

(B) Nonelective deferred compensation. For purposes of subparagraph (A), deferred compensation shall be treated as nonelective only if all individuals (other than those who have not satisfied any applicable initial service requirement) with the same relationship to the payor are covered under the same plan with no individual variations or options under the plan.

(13) Special rule for churches. The term "eligible employer" shall not include a church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

(14) Treatment of qualified governmental excess benefit arrangements. Subsections (b)(2) and (c)(1) shall not apply to any qualified governmental excess benefit arrangement (as defined in section 415(m)(3)), and benefits provided under such an arrangement shall not be taken into account in determining whether any other plan is an eligible deferred compensation plan.

(15) Applicable dollar amount.

(A) In general. The applicable dollar amount shall be the amount determined in accordance with the following table:

For taxable years	the applicable dollar
beginning in	amount:
calendar year:	
2002	\$ 11,000
2003	\$ 12,000
2004	\$ 13,000
2005	\$ 14,000
2006 or thereafter	\$ 15,000.

(B) Cost-of-living adjustments. In the case of taxable years beginning after December 31, 2006, the Secretary shall adjust the \$ 15,000 amount under subparagraph (A) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase under this paragraph which is not a multiple of \$ 500 shall be rounded to the next lowest multiple of \$ 500.

(16) Rollover amounts.

(A) General rule. In the case of an eligible deferred compensation plan established and maintained by an employer described in subsection (e)(1)(A), if-

(i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an eligible rollover distribution (within the meaning of section 402(c)(4)),

(ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and

(iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

(B) Certain rules made applicable. The rules of paragraphs (2) through (7) and (9) of section 402(c) and section 402(f) shall apply for purposes of subparagraph (A).

(C) Reporting. Rollovers under this paragraph shall be reported to the Secretary in the same manner as rollovers from qualified retirement plans (as defined in section 4974(c)).

(17) Trustee-to-trustee transfers to purchase permissive service credit. No amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is--

(A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or

(B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.

(f) Tax treatment of participants where plan or arrangement of employer is not eligible.

(1) In general. In the case of a plan of an eligible employer providing for a deferral of compensation, if such plan is not an eligible deferred compensation plan, then--

(A) the compensation shall be included in the gross income of the participant or beneficiary for the 1st taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, and

(B) the tax treatment of any amount made available under the plan to a participant or beneficiary shall be determined under section 72 (relating to annuities, etc.).

(2) Exceptions. Paragraph (1) shall not apply to--

(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(B) an annuity plan or contract described in section 403,

(C) that portion of any plan which consists of a transfer of property described in section 83,

(D) that portion of any plan which consists of a trust to which section 402(b) applies, and

(E) a qualified governmental excess benefit arrangement described in section 415(m).

(3) Definitions. For purposes of this subsection

(A) Plan includes arrangements, etc. The term "plan" includes any agreement or arrangement.

(B) Substantial risk of forfeiture. The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual.

(g) Governmental plans must maintain set-asides for exclusive benefit of participants.

(1) In general. A plan maintained by an eligible employer described in subsection (e)(1)(A) shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan described in subsection (b)(6) are held in trust for the exclusive benefit of participants and their beneficiaries.

(2) Taxability of trusts and participants. For purposes of this title--

(A) a trust described in paragraph (1) shall be treated as an organization exempt from taxation under section 501(a), and

(B) notwithstanding any other provision of this title, amounts in the trust shall be includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in this section.

(3) Custodial accounts and contracts. For purposes of this subsection, custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

HISTORY; ANCILLARY LAWS AND DIRECTIVES

Prospective amendment:

Sunset of amendments made by Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16). Pursuant to § 901(a)(1), (b) of Act June 7, 2001, P.L. 107-16 (26 USCS § 1 note), the amendments made to this section by such Act shall not apply to taxable, plan, or limitation years beginning after December 31, 2010, and the Internal Revenue Code of 1986 shall be applied and administered to such years as if the amendments had never been enacted.

Amendments:

In 2001, P.L. 107-16, Sec. 611(d)(3)(B), (e) (applicable to years beginning after 12/31/2001, as provided by Sec. 611(i)(1) of P.L. 107-16, which appears as a note to Code Sec. 415), amended subsec. (b) by substituting "the applicable dollar amount" for "\$ 7,500" in para. (2)(A), and substituting "twice the dollar amount in effect under subsection (b)(2)(A)" for "\$ 15,000" in para. (3)(A); amended subsec. (c) by substituting "the applicable dollar amount" for "\$ 7,500" in para. (1), and substituting "402(g)(7)(A)(iii)" for "402(g)(8)(A)(iii)" in subsec. (2); and amended subsec. (e) by substituting para. (15) for one which

read: "(15) Cost-of-living adjustment of maximum deferral amount. The Secretary shall adjust the \$ 7,500 amount specified in subsections (b)(2) and (c)(1) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1994, and any increase under this paragraph which is not a multiple of \$ 500 shall be rounded to the next lowest multiple of \$ 500."

--P.L. 107-16, Sec. 615(a) (applicable to years beginning after 12/31/2001, as provided by Sec. 615(b) of P.L. 107-16, which appears as a note to this section), substituted subsec. (c) for one which read:

"(c) Individuals who are participants in more than 1 plan.

"(1) In general. The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed the applicable dollar amount (as modified by any adjustment provided under subsection (b)(3)).

"(2) Coordination with certain other deferrals. In applying paragraph (1) of this subsection--

"(A) any amount excluded from gross income under section 403(b) for the taxable year, and

"(B) any amount--

"(i) excluded from gross income under section 402(e)(3) or section 402(h)(1)(B) or (k) for the taxable year, or

"(ii) with respect to which a deduction is allowable by reason of a contribution to an organization described in section 501(c)(18) for the taxable year,

shall be treated as an amount deferred under subsection (a). In applying section 402(g)(7)(A)(iii) or 403(b)(2)(A)(ii), an amount deferred under subsection (a) for any year of service shall be taken into account as if described in section 402(g)(3)(C) or 403(b)(2)(A)(ii), respectively. Subparagraph (B) shall not apply in the case of a participant in a rural cooperative plan (as defined in section 401(k)(7))."

--P.L. 107-16, Sec. 632(c)(1) (applicable to years beginning after 12/31/2001, as provided by Sec. 632(c)(2) of P.L. 107-16, which appears as a note to this section) amended subsec. (b)(2) by substituting "100 percent" for "33 1/2 percent".

--P.L. 107-16, Sec. 641(a)(1)(A)-(C) (applicable to distributions after 12/31/2001, as provided by Sec. 641(f)(1) of P.L. 107-16, which appears as a note to Code Sec. 402), amended subsec. (b)(2) by inserting "(other than rollover amounts)" in the introductory matter; amended subsec. (d)(1) by deleting "and" following the concluding comma in subpara. (A)(iii), substituting ", and" for a concluding period in subpara. (B), and adding subpara. (C) and the concluding matter; and amended subsec. (e) by adding para. (16).

--P.L. 107-16, Sec. 646(a)(3) (applicable to distributions after 12/31/2001, as provided by Sec. 646(b) of P.L. 107-16, which appears as a note to Code Sec. 401), amended subsec. (d)(1)(A)(ii) by substituting "has a severance from employment" for "is separated from service".

--P.L. 107-16, Sec. 647(b) (applicable to trustee-to-trustee transfers after 12/31/2001, as provided by Sec. 647(c) of P.L. 107-16, which appears as a note to Code Sec. 403), amended subsec. (e) by adding para. (17).

--P.L. 107-16, Sec. 648(b) (applicable to distributions after 12/31/2001, as provided by Sec. 648(c) of P.L. 107-16, which appears as a note to Code Sec. 411), amended subsec. (e)(9)(A)(i) by substituting "the portion of such amount which is not attributable to rollover contributions (as defined in section 411(a)(11)(D))" for "such amount".

--P.L. 107-16, Sec. 649(a), (b) (applicable to distributions after 12/31/2001, as provided by Sec. 649(c) of P.L. 107-16, which appears as a note to this section), substituted subsec. (a) for one which read: "(a) Year of inclusion in gross income. In the case of a participant in an eligible deferred compensation plan, any amount of compensation deferred under the plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary."; amended subsec. (d) by substituting para. (2) for one which read:

"(2) Minimum distribution requirements. A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of subparagraphs (A), (B), and (C):

"(A) Application of section 401(a)(9). A plan meets the requirements of this subparagraph if the plan meets the requirements of section 401(a)(9).

"(B) Additional distribution requirements. A plan meets the requirements of this subparagraph if--

"(i) in the case of a distribution beginning before the death of the participant, such distribution will be made in a form under which--

"(I) the amounts payable with respect to the participant will be paid at times specified by the Secretary which are not later than the time determined under section 401(a)(9)(G) (relating to incidental death benefits), and

"(II) any amount not distributed to the participant during his life will be distributed after the death of the participant at least as rapidly as under the method of distributions being used under subclause (I) as of the date of his death, or

"(ii) in the case of a distribution which does not begin before the death of the participant, the entire amount payable with respect to the participant will be paid during a period not to exceed 15 years (or the life expectancy of the surviving spouse if such spouse is the beneficiary).

"(C) Nonincreasing benefits. A plan meets the requirements of this subparagraph if any distribution payable over a period of more than 1 year can only be made in substantially nonincreasing amounts (paid not less frequently than annually).",

and adding para. (3); and amended subsec. (e)(9) by substituting the heading for one which read: "Benefits not treated as made available by reason of certain elections, etc.", and inserting the introductory matter.

In 1997, P.L. 105-34, Sec. 1071(a)(2) (applicable as provided by Sec. 1071(c) of P.L. 105-34, which appears as a note to Code Sec. 411), amended subsec. (e)(9)(A) by substituting "dollar limit" for "\$ 3,500" in the heading and by substituting "the dollar limit under section 411(a)(11)(A)" for "\$ 3,500" in cl. (i).

In 1996, P.L. 104-188, Sec. 1421(b)(3)(C) (applicable to taxable years beginning after 12/31/96, as provided by Sec. 1421(e), which appears as 26 *USCS* § 72 note), substituted "section 402(h)(1)(B) or (k)" for "section 402(h)(1)(B)" in subsec. (c)(2)(B)(i).

--P.L. 104-188, Sec. 1444(b)(2), (3) (applicable to years beginning after 12/31/94 as provided by Sec. 1444(e), which appears as 26 *USCS* § 415 note), added subsec. (e)(14); and amended subsec. (f)(2) by deleting "and" at the end of subpara. (C), substituting ", and" for a period at the end of subpara. (D), and adding subpara. (E).

--P.L. 104-188, Sec. 1447(a) (applicable to taxable years beginning after 12/31/96, as provided by Sec. 1447(c), which appears as a note to this section), amended subsec. (e) by substituting para. (9) for one which read:

"(9) Benefits not treated as made available by reason of certain elections. If--

"(A) the total amount payable to a participant under the plan does not exceed \$ 3,500, and

"(B) no additional amounts may be deferred under the plan with respect to the participant,

the amount payable to the participant under the plan shall not be treated as made available merely because such participant may elect to receive a lump sum payable after separation from service and within 60 days of the election.",

and adding para. (15).

--P.L. 104-188, Sec. 1448(a), (b) (applicable as provided by Sec. 1448(c), which appears as a note to this section), inserted "except as provided in subsection (g)," in the introductory matter of subsec. (b)(6); and added subsec. (g).

--P.L. 104-188, Sec. 1458(a) (applicable to accruals of length of service awards after 12/31/96, as provided by Sec. 1458(c)(1), which appears as a note to this section), substituted subsec. (e)(11) for one which read: "(11) Certain plans excepted. Any bona fide vacation leave, sick leave, compensatory time,

severance pay, disability pay, or death benefit plan shall be treated as a plan not providing for the deferral of compensation."

In 1992, P.L. 102-318, Sec. 521(b)(26), substituted "section 402(e)(3)" for "section 402(a)(8)" in clause (c)(2)(B)(i), effective for distributions after 12/31/92. For special rule, see Sec. 521(e)(2) of this Act which reads as follows:

"(2) Special rule for partial distributions. For purposes of section 402(a)(5)(D)(i)(II) of the Internal Revenue Code of 1986 (as in effect before the amendments made by this section), a distribution before January 1, 1993, which is made before or at the same time as a series of periodic payments shall not be treated as one of such series if it is not substantially equal in amount to other payments in such series."

In 1989, P.L. 101-239, Sec. 7811(g)(4), substituted ", and" for the period at the end clause (d)(1)(A)(iii) . . . Sec. 7811(g)(5), added "and" at end of subclause (d)(2)(B)(i)(I), effective for tax. yrs. begin. after 12/31/88, except as provided by Sec. 1107(c)(2)-(c)(5) of P.L. 99-514, see below.

--P.L. 101-239, Sec. 7816(j), amended para. (e)(13), effective for tax. yrs. begin. after 12/31/87, except as provided in Secs. 6064(d)(2)-(4) of P.L. 100-647, see below.

Prior to amendment, para. (e)(13) read as follows:

"(13) Exception for church plans. The term "eligible deferred compensation plan" shall not include a plan maintained by a church for church employees. For purposes of this paragraph, the term "church" has the meaning given such term by section 3121(w)(3)(A), including a qualified church-controlled organization (as defined in section 3121(w)(3)(B))."

In 1988, P.L. 100-647, Sec. 1011(e)(1), deleted "and paragraphs (2) and (3) of subsection (b)" after "of this subsection" in para. (c)(2) . . . Sec. 1011(e)(2), amended subpara. (d)(1)(A) . . . Sec. 1011(e)(10), amended subclause (d)(2)(B)(i)(I), effective for tax. yrs. begin. after 12/31/88, except as provided by Sec. 1107(c)(2)-(c)(5) of P.L. 99-514, see below.

Prior to amendment, subpara. (d)(1)(A) read as follows:

"(A) the plan provides that amounts payable under the plan will be made available to participants or other beneficiaries not earlier than when the participant is separated from service with the employer or is faced with an unforeseeable emergency (determined in the manner prescribed by the Secretary by regulation), and"

Prior to amendment, subclause (d)(2)(B)(i)(I) read as follows:

"(I) at least 2/3 of the total amount payable with respect to the participant will be paid during the life expectancy of such participant (determined as of the commencement of the distribution), and"

--P.L. 100-647, Sec. 1011(e)(6)(A), deleted "eligible" each place it appeared in Sec. 1107(c)(3) of P.L. 99-514 . . . Sec. 1011(c)(6)(B), added the sentence at the end of Sec. 1107(c)(3)(B) of P.L. 99-514 [reproduced below] . . . Sec. 1011(c)(7)(A), deleted "to employees on August 1, 1986, of" in Sec. 1107(c)(5) of P.L. 99-514 . . . Sec. 1011(c)(7)(B), substituted "to employees on August 16, 1986," for "a deferred compensation plan" in Sec. 1107(c)(5)(A) of P.L. 99-514 . . . Sec. 1011(c)(7)(C), added "maintaining a deferred compensation plan" after "Alabama" in Sec. 1107(c)(5)(A) of P.L. 99-514 . . . Sec. 1011(c)(7)(D), substituted "to individuals eligible to participate on August 16, 1986, in a deferred compensation plan" for "a deferred compensation plan" in Sec. 1107(c)(5)(B) of P.L. 99-514. Amendments above apply to the effective date for amendments made by Sec. 1107(a) of P.L. 99-514, see below.

--P.L. 100-647, Sec. 1011(e)(9), added "after separation from service and" before "within 60 days" in para. (e)(9), effective for yrs. begin. after 12/31/88.

--P.L. 100-647, Sec. 6064(a)(1), added para. (e)(11) . . . Sec. 6064(a)(2), added para. (d)(10) [before amendment by Sec. 1107(a) of P.L. 99-514, . . . Sec. 6064(b)(1), added para. (e)(12) . . . Sec. 6064(b)(2), added para. (d)(11) [before amendment by Sec. 1107(a) of P.L. 99-514, see below] . . . Sec. 6064(c), added para. (e)(13), effective for tax. yrs. begin. after 12/31/87, except as provided in Secs. 6064(d)(2)-(4) of this Act which read as follows:

"(2) Exception for certain collectively bargained plans.--

"(A) In general.--Section 457 of the 1986 Code (as in effect before and after the amendments made by section 1107 of the Reform Act) shall not apply to

nonelective deferred compensation provided under a plan in existence on December 31, 1987, and maintained pursuant to a collective bargaining agreement.

"(B) Nonelective plan.--For purposes of this paragraph, a nonelective plan is a plan which covers a broad group of employees and under which the covered employees earn nonelective deferred compensation under a definite, fixed and uniform benefit formula.

"(C) Termination.--This paragraph shall cease to apply to a plan as of the elective date of the first material modification of the plan agreed to after December 31, 1987.

"(3) Treatment of certain nonelective deferred compensation.--Section 457 of the 1986 Code shall not apply to amounts deferred under a nonelective deferred compensation plan maintained by an eligible employer described in section 457(e)(1)(A) of the 1986 Code (as in effect after the Reform Act)--

"(A) if such amounts were deferred from periods before July 14, 1988, or

"(B) if--

"(i) such amounts are deferred from periods on or after such date pursuant to an agreement which--

"(I) was in writing on such date, and

"(II) on such date provides for a deferral for each taxable year covered by the agreement of a fixed amount or of an amount determined pursuant to a fixed formula, and

"(ii) the individual with respect to whom the deferral is made was covered under such agreement on such date.

Subparagraph (B) shall not apply to any taxable year ending after the date on which any modification of the amount or formula described in subparagraph (B)(i)(II) agreed to in writing before January 1, 1989, is effective. The preceding sentence shall not apply to a modification agreed to in writing before January 1, 1989, which does not increase any benefit of a participant. Amounts described in the first sentence of this paragraph shall be taken into account for purposes of applying section 457 of the 1986 Code to other amounts deferred under any eligible deferred compensation plan.

"(4) Study.--The Secretary of the Treasury or his delegate shall conduct a study on the tax treatment of deferred compensation paid by State and local governments and tax-exempt organizations (including deferred compensation paid to independent contractors). Not later than January 1, 1990, the Secretary shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report on the study conducted under this paragraph together with such recommendations as he may deem advisable."

--P.L. 100-647, Sec. 6071(c), substituted "rural cooperative plan" for "rural electric cooperative plan" in para. (c)(2), effective for tax. yrs. begin. after 11/10/88.

In 1986, P.L. 99-514, Sec. 1107(a), amended Code Sec. 457, effective for tax. yrs. begin. after 12/31/88, except as provided by Sec. 1107(c)(2)-(c)(5) of this Act [as amended by P.L. 100-647, Sec. 1011(e)(6) and (7), see above], which reads as follows:

"(2) Transfers and cash-outs. Paragraphs (9) and (10) of section 457(e) of the Internal Revenue Code of 1986 (as amended by this section) shall apply to taxable years beginning after December 31, 1986.

"(3) Application to tax-exempt organizations.

"(A) In general. Except as provided in subparagraph (B), the application of section 457 of the Internal Revenue Code of 1986 by reason of the amendments made by this section to deferred compensation plans established and maintained by organizations exempt from tax shall apply to taxable years beginning after December 31, 1986.

"(B) Existing deferrals and arrangements. Section 457 of such Code shall not apply to amounts deferred under a plan described in subparagraph (A) which--

"(i) were deferred from taxable years beginning before January 1, 1987, or

"(ii) are deferred from taxable years beginning after December 31, 1986, pursuant to an agreement which--

"(I) was in writing on August 16, 1986,

"(II) on such date provides for a deferral for each taxable year covered by the agreement of a fixed amount or of an amount determined pursuant to a fixed formula.

Clause (ii) shall not apply to any taxable year ending after the date on which any modification to the amount or formula described in subclause (II) is effective. Amounts described in the first sentence shall be taken into account for applying section 457 to other amounts deferred under any deferred compensation plan.

This subparagraph shall only apply to individuals who were covered under the plan and agreement on August 16, 1986.

"(4) Deferred compensation plans for state judges. The amendments made by this section shall not apply to any qualified State judicial plan (as defined in section 131(c)(3)(B) of the Revenue Act of 1978 as amended by section 252 of the Tax Equity and Fiscal Responsibility Act of 1982).

"(5) Special rule for certain deferred compensation plans. The amendments made by this section shall not apply

"(A) to employees on August 16, 1986, of a nonprofit corporation organized under the laws of the State of Alabama maintaining a deferred compensation plan with respect to which the Internal Revenue Service issued a ruling dated March 17, 1976, that the plan would not affect the tax-exempt status of the corporation, or

"(B) to individuals eligible to participate on August 16, 1986, in a deferred compensation plan with respect to which a letter dated November 6, 1975, submitted the original plan to the Internal Revenue Service, an amendment was submitted on November 19, 1975, and the Internal Revenue Service responded with a letter dated December 24, 1975,

but only with respect to deferrals under such plan."

Prior to amendment, Code Sec. 457 read as follows:

"Sec. 457. Deferred compensation plans with respect to service for state and local governments.

"(a) Year of inclusion in gross income.

"In the case of a participant in an eligible State deferred compensation plan, any amount of compensation deferred under the plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary.

"(b) Eligible state deferred compensation plan defined.

"For purposes of this section, the term "eligible State deferred compensation plan" means a plan established and maintained by a State--

"(1) in which only individuals who perform service for the State may be participants,

"(2) which provides that (except as provided in paragraph (3)) the maximum that may be deferred under the plan for the taxable year shall not exceed the lesser of--

"(A) \$ 7,500, or

"(B) 33 1/3 percent of the participant's includible compensation,

"(3) which may provide that, for 1 or more of the participant's last 3 taxable years ending before he attains normal retirement age under the plan, the ceiling set forth in paragraph (2) shall be the lesser of--

"(A) \$ 15,000, or

"(B) the sum of--

"(i) the plan ceiling established for purposes of paragraph (2) for the taxable year (determined without regard to this paragraph), plus

"(ii) so much of the plan ceiling established for purposes of paragraph (2) for taxable years before the taxable year as has not theretofore been used under paragraph (2) or this paragraph,

"(4) which provides that compensation will be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month,

"(5) which does not provide that amounts payable under the plan will be made available to participants or other beneficiaries earlier than when the participant is separated from service with the State or is faced with an

unforeseeable emergency (determined in the manner prescribed by the Secretary by regulation), and

"(6) which provides that--

"(A) all amounts of compensation deferred under the plan,

"(B) all property and rights purchased with such amounts, and

"(C) all income attributable to such amounts, property, or rights, shall remain (until made available to the participant or other beneficiary) solely the property and rights of the State (without being restricted to the provision of benefits under the plan) subject only to the claims of the State's general creditors.

A plan which is administered in a manner which is inconsistent with the requirements of any of the preceding paragraphs shall be treated as not meeting the requirements of such paragraph as of the first plan year beginning more than 180 days after the date of notification by the Secretary of the inconsistency unless the State corrects the inconsistency before the first day of such plan year.

"(c) Individuals who are participants in more than one plan.

"(1) In general. The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed \$ 7,500 (as modified by any adjustment provided under subsection (b)(3)).

"(2) Coordination with section 403(b). In applying paragraph (1) of this subsection and paragraphs (2) and (3) of subsection (b), an amount excluded during a taxable year under section 403(b) shall be treated as an amount deferred under subsection (a). In applying clause (ii) of section 403(b)(2)(A), an amount deferred under subsection (a) for any year of service shall be taken into account as if described in such clause.

"(d) Other definitions and special rules.

"For purposes of this section--

"(1) State. The term "State" means a State, a political subdivision of a State, and an agency or instrumentality of a State or political subdivision of a State.

"(2) Performance of service. The performance of service includes performance of service as an independent contractor.

"(3) Participant. The term "participant" means an individual who is eligible to defer compensation under the plan.

"(4) Beneficiary. The term "beneficiary" means a beneficiary of the participant, his estate, or any other person whose interest in the plan is derived from the participant.

"(5) Includible compensation. The term "includible compensation" means compensation for service performed for the State which (taking into account the provisions of this section and section 403(b)) is currently includible in gross income.

"(6) Compensation taken into account at present value. Compensation shall be taken into account at its present value.

"(7) Community property laws. The amount of includible compensation shall be determined without regard to any community property laws.

"(8) Income attributable. Gains from the disposition of property shall be treated as income attributable to such property.

"(9) Section to apply to rural electric cooperatives.

"(A) In general. This section shall apply with respect to any participant in a plan of a rural electric cooperative in the same manner and to the same extent as if such plan were a plan of a State.

"(B) Rural Electric Cooperative Defined. For purposes of subparagraph (A), the term "rural electric cooperative means

"(i) any organization which is exempt from tax under section 501(a) and which is engaged primarily in providing electric service on a mutual or cooperative basis, and

"(ii) any organization described in paragraph (4) or (6) of section 501(c) which is exempt from tax under section 501(a) and at least 80 percent of the members of which are organizations described in clause (i).

(10) Certain plans excepted. Any bona fide vacation leave, sick leave, compensatory time, severance pay, disability pay, or death benefit plan shall be treated as a plan not providing for the deferral of compensation.

(11) Exception for nonelective deferred compensation of nonemployees.

(A) In general. This section shall not apply to nonelective deferred compensation attributable to services not performed as an employee.

(B) Nonelective deferred compensation. For purposes of subparagraph (a), deferred compensation shall be treated as nonelective only if all individuals (other than those who have not satisfied any applicable initial service requirement) with the same relationship to the payor are covered under the same plan with no individual variations or options under the plan.

"(e) Tax treatment of participants where plan or arrangement of state is not eligible.

"(1) In general. In the case of a plan of a State providing for a deferral of compensation, if such plan is not an eligible State deferred compensation plan, then--

"(A) the compensation shall be included in the gross income of the participant or beneficiary for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, and

"(B) the tax treatment of any amount made available under the plan to a participant or beneficiary shall be determined under section 72 (relating to annuities, etc.).

"(2) Exceptions. Paragraph (1) shall not apply to--

"(A) is a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan or contract described in section 403,

"(C) that portion of any plan which consists of a transfer of property described in section 83, and

"(D) that portion of any plan which consists of a trust to which section 402(b) applies.

"(3) Definitions. For purposes of this subsection--

"(A) Plan includes arrangements, etc. The term 'plan' includes any agreement or arrangement.

"(B) Substantial risk of forfeiture. The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual."

In 1984, P.L. 98-369, Sec. 491(d)(33), deleted subpara. (e)(2)(C) and redesignated subparas. (e)(2)(D) and (E) as subparas. (e)(2)(C) and (D), effective for obligations issued after 12/31/83.

Prior to deletion, subpara. (e)(2)(C) read as follows:

"(C) a qualified bond purchase plan described in section 405(a),".

In 1982, P.L. 97-248, Sec. 252, added para. (c)(3) to Sec. 131 of P.L. 95-600, reproduced below.

In 1980, P.L. 96-222, Sec. 101(a)(4), amended subpara. (d)(9)(B), effective for tax. yrs. begin. after 12/31/78. Secs. 131(c)(2) and (3) of P.L. 95-600 [as amended by Sec. 252 of P.L. 97-248, see above] provides transitional rules, reproduced below.

Prior to amendment, subpara. (d)(9)(B) read as follows:

"(B) Rural electric cooperative defined. For purposes of subparagraph (A), the term 'rural electric cooperative' means--

"(i) any organization described in section 501(c)(12) which is exempt from tax under section 501(a) and which is engaged primarily in providing electric service, and

"(ii) any organization described in section 501(c)(6) which is exempt from tax under section 501(a) and all the members of which are organizations described in clause (i)."

In 1978, P.L. 95-600, Sec. 131(a), added Code Sec. 457, effective for tax. yrs. begin. after 12/31/78. Secs. 131(c)(2) and (3) of this Act [as amended by Sec. 252 of P.L. 97-248, see above] provides transitional rules as follows:

"(2) Transitional rules.

"(A) In general. In the case of any taxable year beginning after December 31, 1978, and before January 1, 1982--

"(i) any amount of compensation deferred under a plan of a State providing for a deferral of compensation (other than a plan described in section

457(e)(2) of the Internal Revenue Code of 1954), and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary, but

"(ii) the maximum amount of the compensation of any one individual which may be excluded from gross income by reason of clause (i) and by reason of section 457(a) of such Code during any such taxable year shall not exceed the lesser of--

"(I) \$ 7,500, or

"(II) 33 1/3 percent of the participant's includible compensation.

"(B) Application of catch-up provisions in certain cases. If, in the case of any participant for any taxable year, all of the plans are eligible State deferred compensation plans, then clause (ii) of subparagraph (A) of this paragraph shall be applied with the modification provided by paragraph (3) of section 457(b) of such Code.

"(C) Applications of certain coordination provisions.-- In applying clause (ii) of subparagraph (A) of this paragraph and section 403(b)(2)(A)(ii) of such Code, rules similar to the rules of section 457(c)(2) of such Code shall apply.

"(D) Meaning of terms. Except as otherwise provided in this paragraph, terms used in this paragraph shall have the same meaning as when used in section 457 of such Code.

"(3) Deferred compensation plans for state judges.--

"(A) In general.--The amendments made by this section shall not apply to any qualified State judicial plan.

"(B) Qualified state judicial plan.--For purposes of subparagraph (A), the term 'qualified State judicial plan' means any retirement plan of a State for the exclusive benefit of judges or their beneficiaries if--

"(i) such plan has been continuously in existence since December 31, 1978,

"(ii) under such plan, all judges eligible to benefit under the plan--

"(I) are required to participate, and

"(II) are required to contribute the same fixed percentage of their basic or regular rate of compensation as judge,

"(iii) under such plan, no judge has an option as to contributions or benefits the exercise of which would affect the amount of includible compensation,

"(iv) the retirement payments of a judge under the plan are a percentage of the compensation of judges of that State holding similar positions, and

"(v) the plan during any year does not pay benefits with respect to any participant which exceed the limitations of section 415(b) of the Internal Revenue Code of 1954."

Other provisions:

Application of amendments made by § 1447 of Act Aug. 20, 1996. Act Aug. 20, 1996, P.L. 104-188, Title I, Subtitle D, Ch 4, § 1447(c), 110 Stat. 1812, provides: "The amendments made by this section [amending subsec. (e)(9) and adding subsec. (e)(15) of this section] shall apply to taxable years beginning after December 31, 1996."

Application of amendments made by § 1448 of Act Aug. 20, 1996. Act Aug. 20, 1996, P.L. 104-188, Title I, Subtitle D, Ch 4, § 1448(c), 110 Stat. 1213, provides:

"(1) In general. Except as provided in paragraph (2), the amendments made by this section [amending subsec. (b)(6) and adding subsec. (g) of this section] shall apply to assets and income described in section 457(b)(6) of the Internal Revenue Code of 1986 held by a plan on and after the date of the enactment of this Act.

"(2) Transition rule. In the case of a plan in existence on the date of the enactment of this Act, a trust need not be established by reason of the amendments made by this section [amending subsec. (b)(6) and adding subsec. (g) of this section] before January 1, 1999."

Application of amendments made by § 1458(a) of Act Aug. 20, 1996. Act Aug. 20, 1996, P.L. 104-188, Title I, Subtitle D, Ch 4, § 1458(b), 110 Stat. 1820, provides: "The amendment made by subsection (a) [amending subsec. (e)(11) of this section] shall apply to accruals of length of service awards after December 31, 1996."

Application of amendment made by § 615 of Act June 7, 2001. Act June 7, 2001, P.L. 107-16, Title VI, Subtitle B, § 615(b), 115 Stat. 102, provides: "The amendment made by subsection (a) [amending subsec. (c) of this section] shall apply to years beginning after December 31, 2001."

Application of amendment made by § 632(c) of Act June 7, 2001. Act June 7, 2001, P.L. 107-16, Title VI, Subtitle C, § 632(c)(2), 115 Stat. 115, provides: "The amendment made by this subsection [amending subsec. (b)(2)(B) of this section] shall apply to years beginning after December 31, 2001."

Application of amendments made by § 649 of Act June 7, 2001. Act June 7, 2001, P.L. 107-16, Title VI, Subtitle D, § 649(c), 115 Stat. 128, provides: "The amendments made by this section [amending subsecs. (a), (d), and (e)(9) of this section] shall apply to distributions after December 31, 2001."

NOTES:

CROSS REFERENCES

General rule for taxable year of inclusion, 26 *USCS* § 451.

RESEARCH GUIDE

Am Jur:

9 Am Jur 2d, Bankruptcy § 35.

33A Am Jur 2d, Federal Taxation (2000) PP 8176-8184, 8764, 9017.

70C Am Jur 2d, Social Security and Medicare § § 170, 174, 179, 498.

Law Review Articles:

Altieri. Section 457 deferred compensation plans after TAMRA: the forest and the trees. 14 *Rev Tax Individuals* 40.

IRS News: 'Bona Fide' Benefits Not Subject to Section 457. 39 *Tax Notes* 1247, June, 1988.